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Insurers, CLOs, and High-Risk Borrowers: Oh My!

By Editorial Staff *Fri, Aug 1, 2025*

By purchasing tranches of collateralized loan obligations (CLOs), insurers increasingly 'provide the ultimate funding for bank loans,' recent research says. 'Understanding these transmission channels from non-bank investors to borrowers is crucial for assessing financial stability in modern credit markets.'

The practice of bundling high-yield loans to high-risk companies into collateralized loan obligations (CLOs), slicing the CLOs into tranches of descending seniority, and selling the tranches at varying prices to institutional investors, has grown rapidly over the past 20 years.

Insurers, with their $12.8 trillion in assets, are the biggest funders of CLOs. Their purchases finance new leverage loans, expand access to credit for non-traditional borrowers, pool and diversify financial risk, and, in theory, provide insurers and other buy-and-hold investors with higher risk-adjusted returns on their policyholders' money.

As life insurers sell more investment-like products and fewer "biometric" life-contingent products, CLO tranches are a way for them to fine-tune and optimize their financial risk and return ratios.

To strike an analogy, they are reminiscent of the resistors and capacitors in computers that deliver exactly the right amount of power to each sub unit. CLOs are a key component of the Bermuda Triangle strategy: Private credit companies buy life insurance companies so that they use annuity revenue to fund their leveraged loans.

In a recent working **paper** from the National Bureau of Economic Research ("Does Loan Securitization Expose Borrowers to Non-Bank Investor Shocks?") three economists study the chain of cash flows between insurers, CLO bundlers, and high-risk borrowers.

The authors, Abhishek Bhardwaj, Shan Ge, and Saptarshi Mukherjee, say they've found that fluctuations in insurers' appetites for CLOs creates uncertainty for the original private-credit borrowers. Using detailed data on insurance companies, the largest class of CLO investors, the authors found that:

- Concentrated capital and sticky relationships expose insurer to idiosyncratic shocks.
- Capital supply-driven CLO formations lead firms to increase borrowing, grow employment, and expand operations.
- CLO managers respond to the increase in investor capital by launching more deals.

- Private firms, which likely have larger unmet financing needs, drive the effects.
- CLOs fund 65% of syndicated loans, theoretically insulating borrowers from bank and idiosyncratic investor shocks.

“These findings have two critical implications for credit markets. While loan securitization may reduce firms’ exposure to bank-specific shocks, it creates new exposure to non-bank investor shocks through the CLO market. Moreover, increased CLO investor capital does more than facilitate bank risk transfer—it expands credit access and drives real economic activity.

“Understanding these transmission channels from non-bank investors to borrowers is crucial for assessing financial stability in modern credit markets, where these investors increasingly provide the ultimate funding for bank loans.”